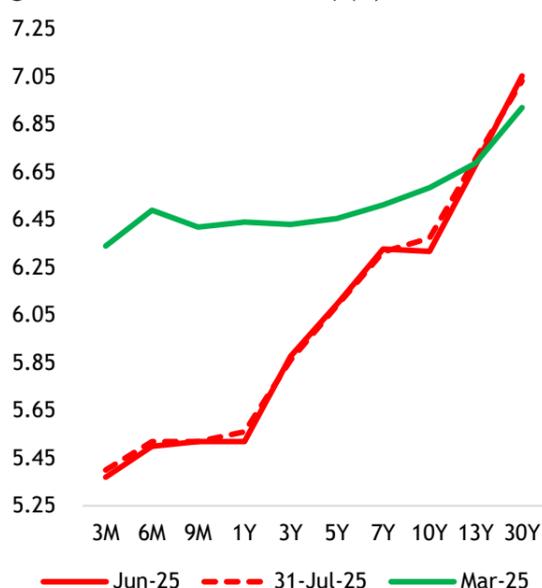


Fig. 1: Yield Curve movement, (%)



Source: Bloomberg, UBI Research

US imposed a 25% tariff on all Indian exports effective August 1, excluding pharma and electronics, escalating trade tensions and triggering market volatility. This move follows the collapse of trade talks over agriculture access and India's defense and energy ties with Russia. We estimate a direct drag of 30 basis points on India's GDP growth, or USD 10-12 billion, via the exports channel, with additional downside risks if penalties are extended to strategic sectors. The worst-hit sectors include jewellery, textiles, and auto components, while agriculture has been shielded due to India's firm stance. Risks of Chinese dumping in electronics, chemicals, and solar sectors are also on watch. Despite these external shocks, India's macro backdrop remains relatively resilient. CPI inflation dropped sharply to 2.1% in June, with July tracking even lower at around 1.7%. While the disinflation offers policy room, markets expect no rate action in the upcoming August 6 MPC meeting. Instead, all eyes are on the RBI's liquidity management framework review, which is expected to enhance transparency and communication on rate and liquidity tools. Bond markets remained largely range-bound in July, with the 10-year yield closing near 6.37%, supported by comfortable system liquidity and well-subscribed auctions. External pressures such as a weakening rupee and rising US Treasury yields have capped any sharp rally. While the situation remains fluid, India's refusal to concede to unfavourable terms—unlike several other economies—underscores its commitment to strategic autonomy. Whether this episode results in another "TACO" (Trump Always Chickens Out) moment remains to be seen, but for now, the policy response has been measured, with earlier easing steps by the MPC ensuring room to manoeuvre in a volatile global environment.

US yields rise amid strong data and mixed inflation signals:

- In July, the US bond market saw rising yields, with the 10-year Treasury moving from around 4.26% at the start of the month to a peak of 4.50% by mid-July, before easing slightly to about 4.43% by month-end. This rise was mainly driven by stronger-than-expected economic data, especially June retail sales, which came in at +0.6% versus just +0.1% expected, and a solid nonfarm payrolls report at 147K jobs added. While the ADP employment report surprised on the downside (-33K), weekly jobless claims steadily declined through the month, showing the labor market remains relatively healthy. The unemployment rate also fell to 4.1%, better than the expected 4.3%.
- Inflation data was mixed. June CPI rose to 2.7% YoY, with core inflation at 2.9%, slightly higher than expected. Producer price inflation remained stable, but upward price pressures from new tariffs introduced by the Trump administration added to market caution.
- At its July 30 meeting, the Federal Reserve kept the federal funds rate unchanged at 4.25 to 4.50% for the fifth straight time, citing elevated uncertainty around the economic outlook and persistent inflation pressures. While GDP expanded at a modest 1.2% annualized pace in H1 2025, Chair Powell noted signs of cooling consumer demand and emphasized a data-dependent approach going forward. Inflation remains somewhat above target, and recent tariffs have added to global trade uncertainty.
- Despite growing political calls for rate cuts—including dissents from two Fed governors in favor of easing—Powell reaffirmed the Fed's independence, stating there is no pre-set course for policy and no decision yet for September. The message to markets was clear: the Fed remains cautious, flexible, and committed to its dual mandate, awaiting more clarity on how growth, labor markets, and inflation evolve amid rising geopolitical and trade risks.

Trump's tariff on India: direct impact on growth of ~30bps and ~\$12Bn:

- United States has imposed a 25% tariff on all Indian exports starting August 1, 2025. This follows a breakdown in trade talks over disagreements on agricultural access and Russian imports. The new measures are expected to lower India's GDP growth by around 30 basis points, with a direct impact of \$10-12 billion through reduced exports. Sectors like jewellery, textiles, and auto components are likely to face the most pressure, while agriculture remains less affected due to India holding its ground during negotiations.
- Financial markets have reacted with increased volatility, a weakening rupee, and softer investor sentiment. The situation may worsen if the US extends tariffs to sectors like pharma and electronics or if sanctions are broadened. Concerns also remain about dumping from China in sensitive sectors such as chemicals, electronics, and solar. While it's too early for a fiscal policy response, the Monetary Policy Committee's recent steps to ease rates and liquidity, and its shift to a neutral stance, provide room to respond if needed. No major changes are expected in the upcoming MPC meeting..
- India's firm position, even as other countries agreed to less favorable terms with the US, signals a strategic shift. The government has emphasized protecting key sectors like agriculture, despite facing political criticism. These developments may push India to reduce its reliance on the US and strengthen ties with other global partners as it navigates an increasingly uncertain trade and geopolitical environment.

India Jun'25 CPI surprise on downside, fall to 2.1%:

- CPI inflation for the month of Jun'25 has fallen sharply to 2.1%, its lowest since Jan'19 vis-à-vis 2.82% in May'25. The main driver of this steep fall has been the food inflation which has slipped into negative zone at -0.2% while core CPI clocked as expected at 4.43% vs 4.24% in May. Interestingly, broad basing of fall in inflation underway as CPI excluding vegetables inflation continued to cool from 4% in May to 3.8% in June.
- Core inflation has printed 4.43% y/y in June, in line with our projections, vis-à-vis 4.24% last month and 3.14% in June'24. While the reading was slightly higher in line with the increase in gold prices during the month (driving rise in Personal care inflation from 13.5% in May to 14.76% in June), the interesting factor here is core-ex-gold which also edged up to 3.5% from 3.4% last month. This can be attributed to sequential jump in education inflation which has gone up from 0.26% in May to 0.89% in June (m/m).
- We see July inflation at near term bottom with the number currently tracking close to 1.7%. For FY26, we recently revised our CPI forecast downward to 3.6% from 4.0% and vis-à-vis 3.7% projection of MPC. This forecast is premised on food inflation cooling in FY26 to 3% (lowest in 7 years), after remaining sticky in 6.5-7.0% range consistently during FY23-25.

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Liquidity and Money market :

- The banking system remained in surplus for the month of Jul'25 averaging Rs.3.08 lakh crore higher than previous month average of Rs.2.74 lakh core. The WACR was more aligned to repo rate, as VRRR were conducted during the month of July.
- As per RBI weekly data, the Govt. balance has lowered to Rs.2.11 lakh crore. With this the Core liquidity amounts to Rs.5.49 lakh crore. Going ahead, we expect the system liquidity to continue hovering around 1% of NDTL.
- Credit growth trends reveal that the overall advances of the banking system have experienced a 9.8% growth, while deposits have seen a growth of 10.1% as of 11th Jul, 2025. This gap between credit and deposit growth stands at -33 bps.
- During Jul'25, a total of 7 no.s VRRR were conducted to fine tune money market operations amid surplus liquidity. RBI conducted back-to-back VRRs, Rs.50,000 crore each for 2-day and 1-day tenors, following a Rs.2.0 lakh crore VRRR on 18th Jul (reversed on 25th). Despite overall surplus liquidity, temporary tightness from GST outflows and funds locked in VRRRs pushed WACR to 5.73%, near the MSF rate. The RBI's dynamic use of VRR operations helped manage short-term liquidity mismatches and stabilize overnight rates.

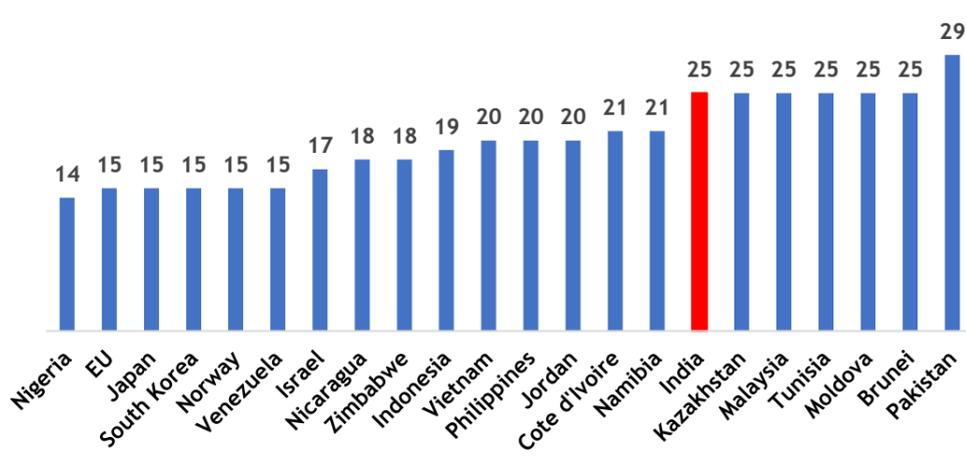
India 10 year steady, Liquidity Management Framework in spotlight:

- The Indian government bond yield curve remained largely range-bound in July, but signs of structural softening are emerging due to improving macroeconomic conditions, evolving RBI guidance, and robust foreign inflows.
- India's benchmark 10-year government bond yield remained range-bound throughout July, trading between 6.31% and 6.38%, closing the month near 6.37%. This stability reflected a mix of supportive domestic macroeconomic conditions and cautious sentiment stemming from global rate movements.
- On the domestic front, economic data continued to support the case for easing bond yields. June CPI inflation came in at 2.1%, down from 2.8% in May, staying well within the RBI's 2-6% target band. This, combined with a slowdown in IIP (Index of Industrial Production) growth and a moderation in credit growth, gave markets confidence that inflationary pressures are easing and the monetary policy cycle may shift further toward accommodation in the coming months.
- However, the yield curve remained under mild pressure due to external developments. Rising US 10-year Treasury yields, which peaked at 4.50% mid-month, narrowed the spread between Indian and US bonds. This dampened foreign appetite for Indian debt and made traders cautious of a potential outflow of global capital. Moreover, the Indian rupee weakened during the month of July by more than 2%, which further limited room for domestic yields to soften.
- Despite these external factors, the demand for government securities remained robust. Primary auctions were well subscribed, supported by improved banking system liquidity, healthy institutional demand, and a stable fiscal outlook. *Shorter-end yields saw slightly more compression than the long end, steepening the curve modestly and suggesting a patient wait-and-watch approach by market participants.*
- Domestic Macro: Disinflation and Policy Room: The standout macro development was the sharp decline in June CPI inflation to 2.1%, the lowest in this cycle and well below the RBI's 4% target. This disinflationary trend opens up space for policy easing. While the RBI Governor has not signalled an imminent rate cut, his recent remarks confirm the central bank's flexibility and data-dependent approach.
- Foreign Flows and Long-End Support: Despite global headwinds, particularly elevated US 10-year yields (~4.35%), Indian G-Secs received continued foreign inflows under the Fully Accessible Route (FAR). July saw sustained demand for 14-30 year maturities, as global investors positioned for India's inclusion in the FTSE Emerging Markets Government Bond Index (FTSE EMGBI) from September 2025. These inflows have anchored the long end of the curve and may continue to offset volatility from external rate movements.
- Liquidity Management: Actively Calibrated by RBI: System liquidity remained in surplus through much of July, peaking above Rs.4 lakh crore. The RBI conducted frequent Variable Rate Reverse Repo (VRRR) auctions to absorb the excess. However, mid-month GST payments and tax outflows led to temporary tightness, pushing the Weighted Average Call Rate (WACR) to 5.62% and TREPS to 5.70%, briefly crossing the 5.50% repo rate and even exceeding the Marginal Standing Facility (MSF) ceiling. In response, the RBI injected funds through overnight Variable Rate Repo (VRR) operations, stabilizing funding costs and reinforcing its commitment to keeping overnight rates within the policy corridor. As per [media reports](#), some banks requesting a return to fixed-rate daily repos for more predictable access during liquidity stress, although RBI is unlikely to reintroduce this facility and remains committed to variable-rate operations that reflect market-based pricing. Additionally, banks have sought relaxation in the daily CRR maintenance requirement, but no decision has been communicated yet. With the liquidity management framework review expected to conclude by August 6, alongside the next monetary policy announcement, markets are anticipating a blend of continuity in operating targets and meaningful upgrades to liquidity tools.
 - Retaining WACR as the Operating Target: WACR is expected to remain the RBI's core operating target due to its strong alignment with the repo rate and its critical role in monetary transmission.
 - WACR vs TREPS: While rising TREPS volumes have raised questions about WACR's relevance, the two rates are highly correlated (~98%), as confirmed by the RBI Governor. WACR remains preferred given its regulatory oversight and transmission effectiveness.
 - Key Reforms Under Consideration:
 - With 14-day VRR auctions mostly inactive recently, the RBI is expected to prioritize 7-day VRRs for more flexible, weekly liquidity management. This marks a shift from the earlier focus on longer-tenure repos to shorter-term instruments in line with current practices
 - SORR implementation of [December 2024 proposal](#): The Secured Overnight Reference Rate (SORR), based on actual TREPS transactions, may soon become the new benchmark for overnight rates, offering greater transparency and market alignment.
 - These anticipated changes reflect the RBI's broader objective of modernizing its liquidity toolkit, reducing reliance on legacy instruments, and ensuring that short-term interest rates remain stable, predictable, and closely aligned with the policy stance.

Table 2: Market Snapshot		
	Yield (31 Jul)	Monthly Change
10 Year G-Sec (6.33% GS 2035)	6.37%	+06 bps
1 Year T-Bill	5.56%	+04 bps
US 10 year Yield	4.35%	-12 bps
Credit Growth (%) (as of 11 th Jul'25)	9.8%	+34 bps
Deposit Growth (%) (as of 11 th Jul'25)	10.1%	+09 bps
Credit Deposit Wedge (bps) (as of 11 th Jul'25)	(33)	+25 bps

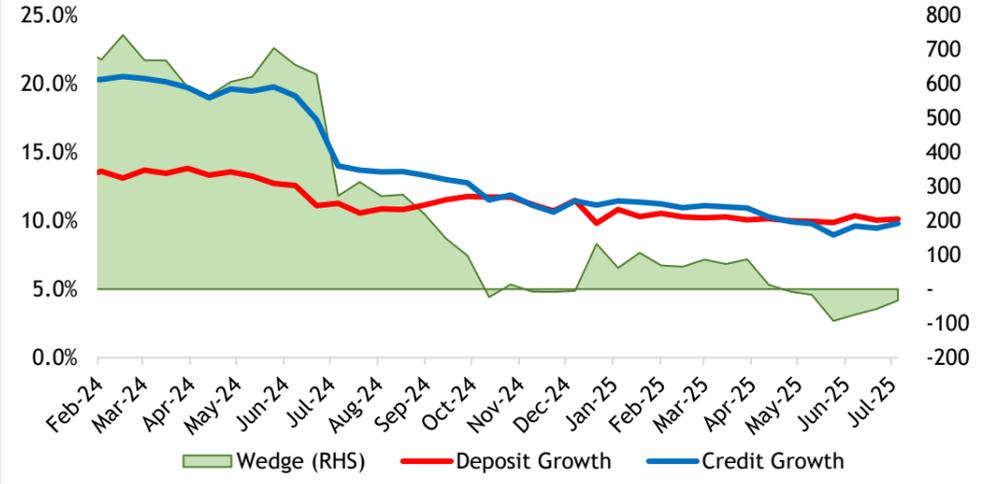
Source: RBI, CCIL, UBI Research

Fig.2: India tariffs are relatively higher yet still competitive vs EM peers



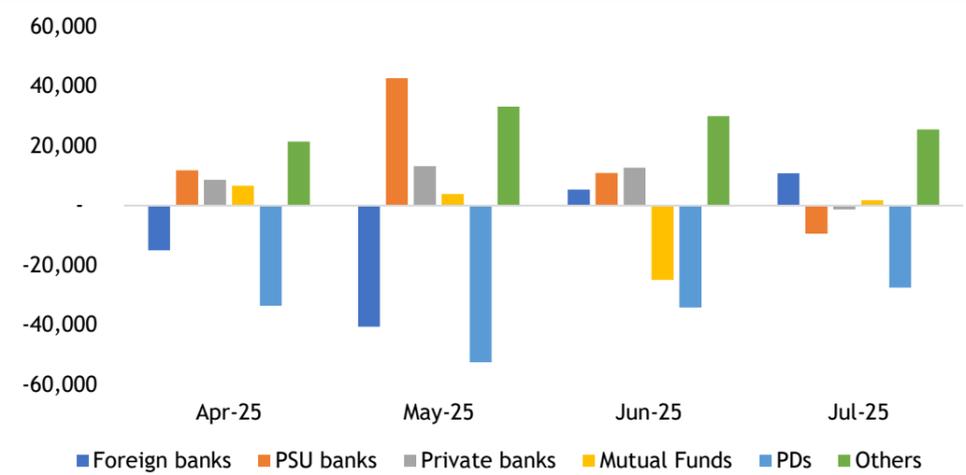
Source: Bloomberg, UBI Research

Fig.3: Credit Deposit growth gap narrowed



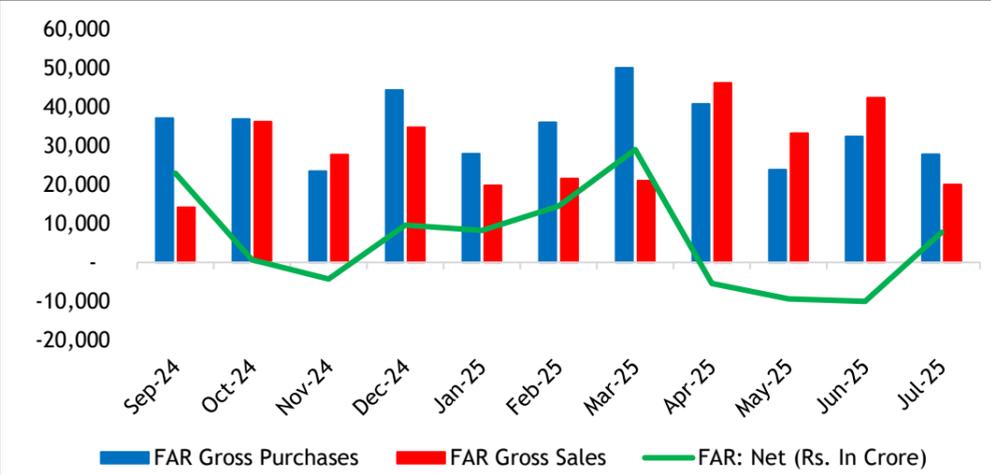
Source: RBI, CEIC, UBI Research

Fig.4: Foreign Banks marginally turned buyers in June and July



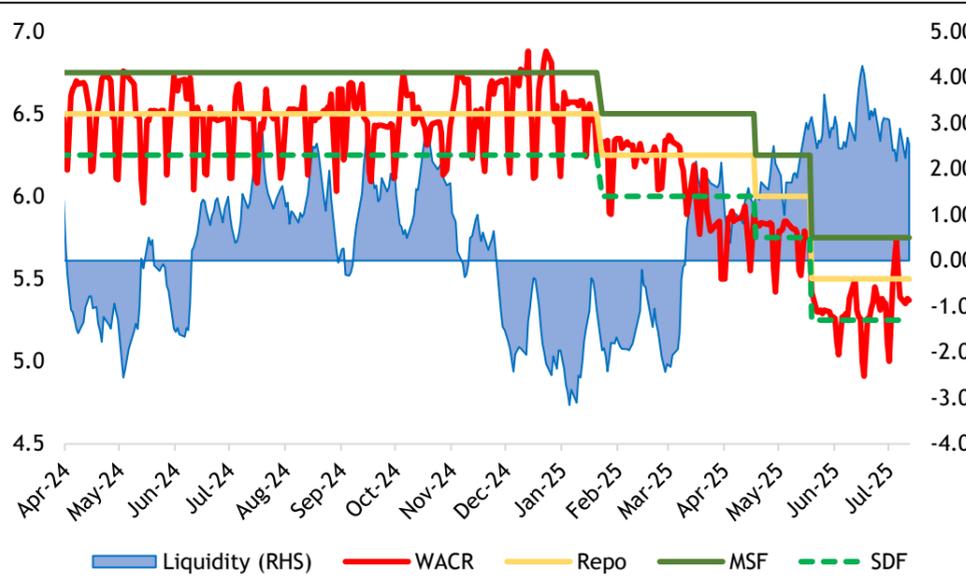
Source: Bloomberg, UBI Research

Fig.5: Net flows in FAR securities showing uptick in Jul'25



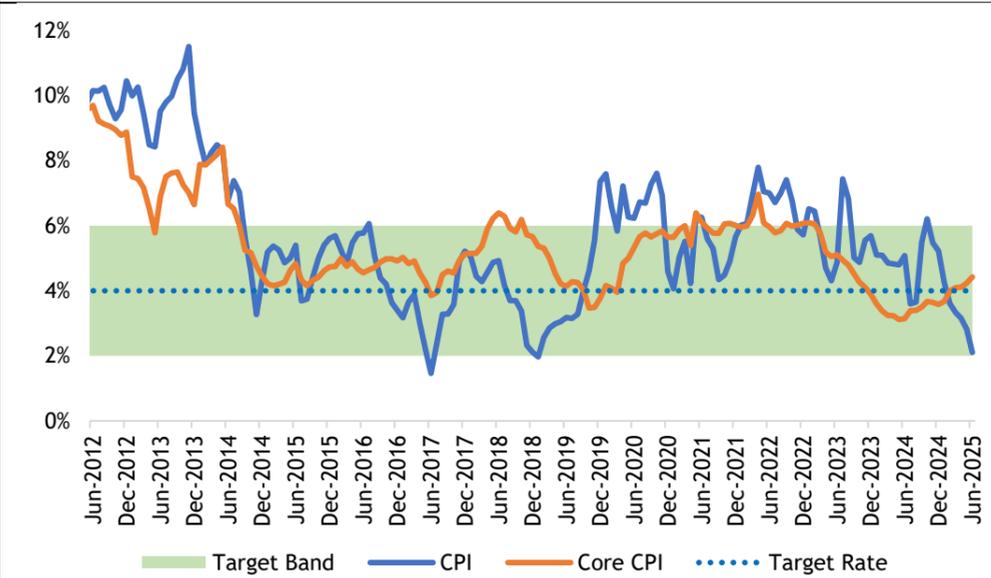
Source: RBI, CEIC, UBI Research

Fig.6: WACR bounced above repo rate for a short while



Source: RBI, CEIC, UBI Research

Fig.7: Sequential uptick in Core CPI



Source: CEIC, UBI Research

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